

Defense Finance 2007
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Transforming Resource Management to Support an Army at War:
Money as a Strategic Weapon

Good morning. Thank you, Mr. Gram, for the kind introduction. It's a pleasure to be here this morning with so many financial management professionals who are keenly aware of the need to transform resource management to support the warfighter.

My topic this morning is "Money as a Strategic Weapon," and I hope you will bear with me as I explore what this term means to today's Army. The concept of money as a weapon originated, at least in recent times, with General Dave Petraeus. Now the senior U. S. military commander in Iraq, General Petraeus commanded the 101st Airborne Division in the initial ground campaign of Operation Iraqi Freedom. In that role, he recognized that cash could be used on the battlefield to achieve positive results with local communities (building schools and clinics, buying intelligence and so forth) and later described money as one of the most important weapons at his disposal in fighting the war.

General Petraeus, of course, had a real-time, tactical perspective on money. Today, I want to step back from that perspective to my perspective as the Army's CFO and talk about money as a weapon in a more strategic sense. In my view, a weapon is anything I can use to enable the Army to supply required military capabilities to the Combatant Commanders on the battlefield, either now and in the future. Money is a finite resource and my primary responsibility is to ensure that the Army makes the most effective and efficient use of this finite resource. If we, in the Army's financial management community can make that happen, we will have accomplished our mission for our Soldiers and the nation.

As the CFO of the remarkable organization that is the United States Army, I've identified three high-priority actions that are critical to our ability to make effective and efficient use of the dollars the nation has entrusted to us, and I've also identified three critical conditions that must exist in order to deliver on those priorities. I'll start by talking about my priorities.

First, we needed to figure out what it costs to execute the missions assigned to the Army. Until 18 months ago, we did not have a clear sense of how much money was required to operate and sustain the Army. We did annual budget justifications and allocated the available appropriations to cover as much as we could. Starting with OSD's strategic guidance, we identified individual programs necessary to achieve the required capabilities and made resource allocation decisions by determining which of those programs could fit inside OSD's fiscal guidance. When it works perfectly (and it never has), this approach optimized use of the available dollars.

Unfortunately, this approach to programming and budgeting does not force a match between available resource requirements and the capabilities called for in OSD's strategic guidance. When we don't have sufficient funding to deliver all the required capabilities, we should be able to articulate this fact to the Army's senior leaders who should be able to engage OSD leadership in a meaningful dialogue to determine how to bring resources and strategy into balance, either by increasing funding or reducing mission requirements.

Early last year, we modeled the cost of the "doctrinal" Army, the Army called for by the National Military Strategy. The Army's operational planners defined the size and composition of the Army required to meet the strategy and the doctrine under which the Army would fight. Then our cost analysts determined what it would cost to produce and sustain this Army.

I won't explain in detail the cost modeling techniques we used in the analysis, but there is one important factor incorporated in the analysis that I would like to talk about briefly.

People often ask whether financial management practices from the private sector are applicable to the military. Well, for several reasons, including government financial standards and the unique missions of the armed forces, many private sector lessons are difficult to apply in DoD. But there is at least one concept that is directly relevant to what we do and warrants significantly greater attention. That concept is depreciation.

Each year the Army spends tens of billions of dollars to build facilities and buy the equipment that our forces need to fight current and future wars. These assets have finite useful lives and will wear out over time. If the Army was planning to go out of business after each war, the gradual reduction in useful life of these assets would be of little concern. But such is not the case. Rather, to use another private sector concept, the Army is a "going concern," an organization that has to be ready to come to the

Nation's defense immediately and is going to operate indefinitely. Therefore, it needs a sustained level of investment to replenish its capital equipment. While we know this, we give this fact minimal attention when we make our resourcing decisions. Rather than set aside the funds to replace a certain percentage of our assets each year, we deal with resource shortfalls in the operating budget by mortgaging the future in order to meet today's urgent requirements.

In our analysis of the cost of sustaining the doctrinal Army, we addressed this long-standing problem by incorporating depreciation of our equipment, including weapons and the buildings on our posts, camps and stations, into our estimate.

Our analysis told us that the cost of the doctrinal Army was approximately \$138 billion per year, \$24 billion more than the Army's fiscal guidance from OSD. Army leadership took this analysis to the Secretary of Defense and, following extensive review of the Army's fiscal situation; additional funds that partially closed the gap were added to the FY08 budget request.

This year, we updated our estimate to reflect the impact of President Bush's decision to grow the Army by thousands of Soldiers. The current cost estimate for sustaining the Army at its proposed size and mission is \$152 billion.

Unfortunately, this analysis will not drive the federal budget process, either within the DoD or in Congress. Congressional action on Defense appropriations is driven by many concerns beyond the need to sustain the Army's readiness. Our challenge is to make this cost analysis a part of our planning and budgeting processes so that we are better resourced to meet the demands of this fight and the next one.

The second critical task is to re-establish strong management controls over our money. We devote most of our time and energy to formulating, submitting, and defending the budget. This is probably as it should be, because without adequate and timely flow of funds from Congress, our operations would grind to a halt. However, while recognizing the importance of the budgeting function, we are focusing more of our attention on developing and applying sound management controls so that we can:

- safeguard our assets,
- ensure compliance with laws and regulations and, perhaps most importantly,
- make the best use of the funds the budgeting process gives us.

During the first part of the current fight, we experienced erosion in our control systems. But through intensive efforts over the last 24 months, we have materially strengthened these critical controls. Here are some of the areas in which improved controls are enabling us to reduce costs with no loss of mission effectiveness:

- Defense Travel System implementation has been accelerated, reducing the number of vouchers processed manually (and our transaction costs at DFAS) and producing much quicker payment to travelers.
- Implementation of Wide Area Workflow is reducing the cost for processing vendor payments and is improving the linkage between the Army's finance and procurement functions.
- Fielding the Funds Control Module provides real-time obligation of supply transactions and dramatically improves the synchronization of finance and supply data.
- Implementing revised policies and procedures for managing Temporary Change of Station orders will give us greater control over this important program and will lead to significant cost reductions.

In dealing with these first two priorities – the costing of the Army and the re-establishment of controls – we have made good progress in the past two years. I'm proud of the hard work that's been done throughout the financial management community, and I have every expectation of continued progress.

The third and final priority is an area where most of the work still lies ahead of us. That priority is to reduce our reliance on supplemental budgets and move base activity back into the base budget.

The use of supplemental budgets is appropriate for funding contingencies that were not anticipated when the budget was developed. Unfortunately, as the global war on terror has continued, we had to use the supplemental budget for more than just the incremental costs of the contingency. As a result of sustained resource shortfalls over the years, the Army was not equipped to provide all the capabilities required for the war. We had to activate, mobilize and train the Reserves; replace old and buy new (and better) equipment; and rebuild worn out posts, camps and stations. Since 9-11, we have increasingly used supplementals to provide not only the funds for day-to-day incremental costs but also to pay for the accumulated capability deficit. In other words, supplementals have been used, in part, to fund costs that should have been in the base budget all

along. This was not a secret. Financial professionals in all parts of the Federal Government recognized this fact and, for various reasons, condoned it. Thus, over the past five years, the boundaries between base activity and contingency activity have become blurred.

This slide describes the situation. The yellow portion of the bars is the funding we've received or requested in our supplemental budgets, stacked on top of the base budget represented in blue. The green shading indicates the migration of base activity and funding into the supplemental. Our concern is that each year an increasing portion of our base activity is being funded by supplementals. On a percentage basis, this is not a huge problem, but it does represent billions of dollars of spending that will need to be reincorporated into the base budget. The problem will become more difficult in the near future because the nation will doubtless do as it has always done and try to harvest the "peace dividend" – that is, reduce Defense spending – before hostilities actually end.

The problem comes into clearer focus when we add the annual cost of the doctrinal Army to the picture. If the war were to end tomorrow and the Army's budget returned immediately to the FY08 base budget level, the resulting strategy-resourcing mismatch would be approximately \$25-30 billion. Even without an immediate end to the war, we expect that political pressures will push for significant reductions in supplemental funding.

With this prospect in sight, we can choose between two courses of action. If we stand back and do nothing, supplemental funding will dry up with no restoration of the base, Army's capabilities will atrophy, and the risk that the Army will not be ready for the next mission in a period of persistent conflict will increase. Instead, we must make a persuasive political case to migrate crucial activities back into the base.

A key component of meeting all three priorities is the adoption by the Army of what I call a "cost culture." I'll explain what I mean by this in a moment, but first I think it's important to understand what we mean by "cultural change." We hear a lot about this idea, and I'm not sure that everyone who uses the term means the same thing.

In any organization, large or small, "culture" refers to how the group behaves and what it believes. For example, the military culture values mission accomplishment, selfless service, valor, and dedication – concepts that help establish the foundation for how our Soldiers, sailors, airmen, and Marines go about their duties. These are concepts and aspects of the military culture that we can all understand.

We intend to adopt a cost culture within the Army. What does that mean? What does a cost culture look like?

Like any management initiative, this concept requires a vision – a description of what the world will look like when the initiative is successful. So it's fair to ask what my vision is for the Army's cost culture is:

All leaders and managers:

- factor cost into their decision-making and understand both the near- and long-term cost implications of their decisions;
 - they make effective trade-off decisions to achieve the best possible use of limited resources; and
 - they focus on improving the efficiency and effectiveness of their operations.
- When there is a gap between mission and money, senior executives are able to engage higher headquarters in meaningful discussions that result in increased funding or reduced requirements;
 - resource management systems support decision-makers with timely, accurate, and reliable cost information; and finally,
 - internal and external stakeholders (Congress and the American people) have the assurance that we are good stewards of the resources that have been entrusted to us.

If that's what a cost culture looks like, how we go about implementing this culture in the Army? As I said at the beginning of this talk, I believe there are three essential conditions for this to succeed.

First, we must have senior leadership engagement. Top-down support and buy-in is essential to the success of almost any management initiative, and this is certainly true of cultural change. Fortunately, in a hierarchical organization like the Army, members of the organization quickly learn to emulate the behavior of the boss. If your boss gives lip service to cost management issues but by his behavior demonstrates that cost considerations are unimportant, you will follow suit. But if, on the other hand, resource stewardship and trade-offs between cost and performance are part of every conversation you have with your boss, you will quickly get the message and alter your behavior.

In this regard, I want to recognize the efforts of the Navy, and in particular CNOs Clark and Mullen, who have developed a program of training and professional development for flag officers that focuses

specifically on the principles of cost management. This program has helped change the Navy culture and is an idea worth emulating.

Second, we need robust toolsets to support the kind of rigorous analysis that must be done to understand cost relationships across wider spans of control in complex organizations. In today's complex, inter-connected Army, we need enterprise solutions that provide Army-wide (if not defense wide) tools and systems. This is why the development and fielding of GFEBS – the General Fund Enterprise Business System – continues to be our number one system priority.

GFEBS is an enterprise system that incorporates three different, but related, views of money: the financial operations view that looks back in time in accounting, reporting and auditing; the budget view that looks to today and tomorrow in allocating resources; and the cost management view that validates affordability for the future, enables performance assessments and frames investment decisions informed by depreciation of assets. GFEBS will synchronize these views of money and provide real-time reporting to financial managers and leaders to better inform decision making.

The third condition is to bring greater discipline to our resource decision-making processes, primarily in achieving a balance between the demand and supply sides of DoD. Demand is defined by the combatant commanders and Joint Staff, who identify what they need in order to accomplish their missions. Supply to meet those demands is provided by the military department headquarters and Defense agencies that are responsible for resourcing and developing programs to produce required capabilities. The interface between supply and demand is difficult to manage in the best of times. In wartime, when the urgency of today's requirements makes it difficult to simultaneously address the future, it becomes even more difficult.

DoD's primary resource decision-making tool the PPBE process, is designed to bring supply and demand into balance. Though it is often criticized, I believe that PPBE is an inherently sound process. If in recent years the war has focused our energy and resources on current requirements, it is not the fault of the system, but rather the result of the critical nature of immediate wartime requirements. The PPBE process offers a platform for disciplined decision-making through a deliberate process that has served the Army and DoD well through other conflicts in our history.

To recap what I've said over the past 20 minutes or so,

- My goal is to make effective, efficient use of money as a weapon in support of building Army capabilities to serve the nation now and in a period of persistent conflict.
- I have three priorities: understanding the cost of the Army as a “going concern,” strengthening financial controls, and migrating core activity back into the base budget.
- These priorities can be achieved against the backdrop of a cost culture throughout the Army.
- Implementation of a cost culture depends on achieving three conditions: getting senior leadership engagement, building robust analytical toolsets, and bringing greater discipline to our resource decision-making processes.
- If we are successful, Army resource managers will serve Army leaders and the American public well.

I thank you for your attention, and with the time remaining I'd be glad to take a few questions.